US Macroeconomics

April 26, 2023

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Jobs Provide Little Lead Time to Recession's Start

Economic data are notoriously volatile and prone to revision, which is why it is so hard to know when the economy is in recession. Take the last non-pandemic downturn which began in January 2008. **In the first half of 2008, originally reported real GDP data showed positive economic growth even though the economy was entering what would be the deepest recession since the 1930s**. Specifically, the first snapshots on Q1 and Q2 2008 real GDP growth were 0.6% and 1.9%, respectively. While Q1 2008 was eventually revised down to -1.6%, Q2 2008 was revised up to 2.3%.

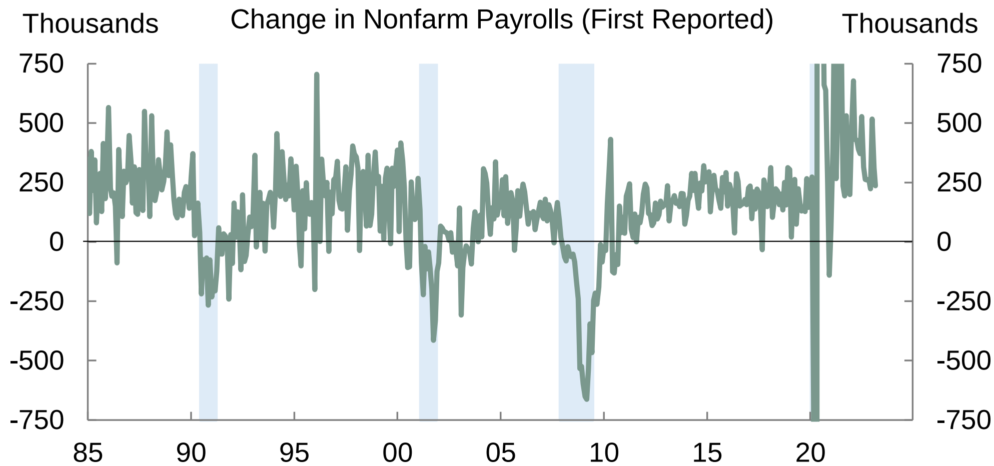
Many analysts at the time said the economy had avoided recession, not unlike those economists who recently were forecasting a "no landing." For a time in 2008, other key data confirmed the soft landing scenario. As we highlighted last week, the ISM Services survey began turning up in April 2008 when the series breached 50. It was not until the Lehman Bankruptcy in September 2008 that ISM services turned down, signaling a contraction in activity.

The employment figures can also provide conflicting real-time signals of the economy's direction. This is evident from the chart below, which shows the originally reported changes in nonfarm payrolls for the last several business cycles alongside recessionary periods, as denoted by the shaded bars. Notably, job growth is positive right up to the point when the economy enters recession. When the economy breaks, it breaks suddenly.

In 1990 nonfarm payrolls were up a small 40k in June following a respectable 164k increase in the previous month. But in July when the economy was on the cusp of recession, jobs plunged an unexpected 219k. The events immediately before the 2001 downturn were even more paradoxical for those wondering whether the economy had skirted a slump.

The labor market started the year on a strong note when January nonfarm payrolls were initially reported to have risen a robust 268k. While February job gains were softer, they still rose a decent 15k. But then in March which marked the peak in economic activity, nonfarm payrolls fell 86k. Recession started the following month.

Job growth will be positive right up to the onset of recession. There will not be any lead time for investors to react. Our best guess is that when employment ultimately turns down, the bond market will price most of the monetary easing to come. The treasury yield curve and the index of leading economic indicators have been foreshadowing recession for the last six months. If investors wait to see negative GDP or employment readings, they will be too late. The time to prepare is now.



Sources: Action Economics, Haver Analytics, SMBC Nikko

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